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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 725

MOLLIE NETCHER NEWBURY,

Petitioner,

vs.

THE UNITED STATES

**PETITION FOR WRIT OF CERTIORARI TO THE
COURT OF CLAIMS AND BRIEF IN SUPPORT
THEREOF.**

LLEWELLYN A. LUCE,

Counsel for Petitioner.



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MOLLIE NETCHER NEWBURY,

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**PETITION FOR A WRIT OF CERTIORARI TO THE
COURT OF CLAIMS OF THE UNITED STATES
AND BRIEF IN SUPPORT THEREOF.**

To the Honorable the Supreme Court of the United States:

Mollie Netcher Newbury, an individual, by her attorney, prays that a writ of certiorari issue to review the judgment of the Court of Claims of the United States entered October 2, 1944, dismissing her petition for the recovery from the United States of \$45,451.34, with interest, on account of the overpayment of Federal income taxes for the years 1935, 1936 and 1937.

Opinion Below

The special findings of fact, conclusions of law and opinion of the Court of Claims (R. 26-42) are unreported but may

be found at Paragraph 62,726, Volume 4, 1944, Edition of Prentice-Hall Federal Tax Service.

Jurisdiction

The judgment of the Court of Claims was entered October 2, 1944. The jurisdiction of this Court is invoked under Section 3(b) of the Act of February 13, 1925.

Statute and Regulations Involved

The pertinent statute and regulations involved in this case are presented in the Appendix, *infra*, pp. 16-17.

Question Presented

The petitioner is the owner of a one-third interest in the annual net income of the Trust Estate of Charles Netcher, deceased, and the owner of a one-third *remainder interest* in the corpus of the trust property.

The question presented is whether under Section 23(1) of the Revenue Acts of 1934 and 1936, the taxpayer is entitled to deduct from her individual gross income one-third of the depreciation sustained by the properties of the trust estate or whether the depreciation deduction is allowable only to the trustee of the Estate.

Statement

The Court of Claims made a Special Findings of Fact (R. 26-33) which may be summarized as follows:

The taxpayer is a citizen and resident of Cook County, Illinois. Charles Netcher, the former husband of the plaintiff, died June 19, 1904, leaving a will which provided in part as follows:

SECOND: All the rest, residue and remainder of my Estate of whatever nature and wherever situate, I

give, bequeath and devise to my said wife, Mollie Netcher, in trust (in this will otherwise described as the Principal Trust Estate) for the uses and purposes following, to wit: -

(a) One-third of the entire net income of said Principal Trust Estate shall be paid over by said trustee, annually or oftener as to said trustee shall seem fit, and as the said income accrues, until the termination of this trust as hereinafter provided, to my said wife, Mollie Netcher, during her life and after her death until the termination of this trust to such person, persons, corporation or corporations and for such purposes as my said wife may by deed or will direct. * * *

(b) The remaining two-thirds of the entire net income of said Principal Trust Estate, shall be divided by said Trustee annually or oftener as to said Trustee shall seem fit, and as said income accrues, until the termination of this trust, as hereinafter provided, into equal shares, one such share to be thereafter held in trust by said trustee as a Separate Trust Fund for each of my children, now or hereafter born to me, who is living at the time of my death or who has died before my death leaving a widow, or child or children living at the time of my death. Each such Separate Trust Fund shall be subject to the provisions, limitations and conditions hereinafter provided with respect to the same. * * *

Charles Netcher was survived by his wife, the taxpayer and petitioner herein, who has since married Mr. Saul Newbury, and by four children. The taxpayer is known as "Mollie Netcher Newbury".

Under the will of the decedent, the taxpayer, during the years 1935, 1936 and 1937, acted as Trustee of the properties of the Estate and was the owner in her individual capacity of a one-third interest in the annual net income of the trust and a one-third remainder interest in the trust corpus. She filed, as trustee, fiduciary Federal in-

come tax returns on Form 1041 for the trust estate for each of the years involved, 1935, 1936 and 1937.

The petitioner also filed individual Federal income tax returns for the years 1935, 1936 and 1937 in which she deducted \$47,623 for 1935, \$47,623 for 1936 and \$45,434.71 for 1937, representing her one-third share of the depreciation sustained by the properties of the trust estate.

The Commissioner of Internal Revenue determined that all deductions for depreciation on the properties of the Trust Estate were allowable only to the Trustee of the Trust Estate and that the petitioner herein, although the owner of a one-third interest in the net annual income from the estate and the owner of a one-third remainder interest in the trust corpus, was not entitled to any deductions, in her individual capacity, for depreciation on the assets of the trust estate. The Commissioner disallowed the deductions for depreciation taken by the taxpayer on her individual tax returns for the years 1935, 1936 and 1937 and assessed additional income taxes against her amounting to \$12,738.79 for 1935, \$12,780.36 for 1936 and \$12,489 for 1937. The petitioner paid the additional taxes plus interest and filed timely claims for refund to recover the additional taxes and interest paid for each year. The taxpayer's claims for refund were rejected by the Commissioner and she filed a petition in the Court of Claims of the United States to recover the additional taxes and interest paid.

The petitioner urged before the Court of Claims that as the owner of a one-third interest in the annual net income from the trust properties and a one-third remainder interest in the trust corpus she was entitled under Section 23(1) of the Revenue Acts of 1934 and 1936 to deduct from her individual gross income one-third of the depreciation sustained by the properties of the trust estate.

The Court of Claims dismissed the taxpayer's petition on the ground that under Section 23(1) of the Revenue Acts of 1934 and 1936 the petitioner was not individually entitled to any deductions for depreciation on the assets of the trust estate and that deductions for depreciation were allowable only to the Trustee:

Specification of Errors To Be Urged

The court below erred:

1. In deciding that the Trustee of the Trust Estate was entitled to all deductions for depreciation on the properties of the estate, thus excluding the petitioner from any depreciation allowances even though she was the owner of a one-third interest in the annual net income of the trust and the owner of a one-third remainder interest in the trust corpus.

2. In failing to hold and decide that the petitioner, as the owner of a one-third interest in the annual net income of the trust and the owner of a one-third remainder interest in the trust corpus, was entitled to deduct from her gross income for the years 1935, 1936 and 1937 one-third of the depreciation sustained by the trust properties in each of those years.

3. By failing to hold and decide that the petitioner was the owner of an equitable fee interest in one-third of the trust properties and as a fee owner was expressly entitled under Section 23(1) of the Revenue Acts of 1934 and 1936 to deduct from her individual gross income one-third of the depreciation sustained by the trust properties during the years 1935, 1936 and 1937.

4. By failing to hold and decide that the petitioner had a far greater interest in the trust properties than that of a

mere life tenant and was therefore entitled under Section 23(1) of the Revenue Acts of 1934 and 1936 to deduct from her gross income one-third of the depreciation sustained by the trust properties during the years 1935, 1936 and 1937.

5. By regarding the petitioner's interest in the trust properties as that of a mere life beneficiary without a remainder interest and thus deciding that petitioner was not entitled under Section 23(1) of the Revenue Acts of 1934 and 1936 to deduct from individual gross income any share of the depreciation sustained by the properties of the trust.

6. In its conclusion of law that the petition of the taxpayer should be dismissed.

7. In rendering judgment for the defendant below and in failing to render a judgment that petitioner was entitled to recover from the defendant the sum of \$45,451.34, plus statutory interest thereon, for overpayment of her Federal income taxes for the years 1935, 1936 and 1937.

Reasons for Granting the Writ

1. The Court of Claims has decided an important question of Federal tax law, which has not been, but should be, settled by this Honorable Court.

Section 23(1) of the Revenue Acts of 1934 and 1936 (App. p. 16) provides that in the case of property held by one person for life with remainder to another person, the deduction for depreciation " * * * shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. * * * " Article 23(1) of Treasury Regulations 86 and 94 (App. pp. 16-17), in interpreting the statute, provides that the deduction for depreciation shall be computed as if the life tenant were the

absolute owner of the property "so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, will be allowed to the remainderman."

Here the petitioner had a far greater interest in the properties of the trust estate than a mere life tenant. The Court of Claims held in its opinion (R. 34) that petitioner had a one-third interest in the annual net income of the trust and a one-third *remainder interest* in the *trust corpus*. She had a life estate plus a remainder interest in the trust corpus which, under the decisions of the courts of the State of Illinois, where the properties are located, constitutes a fee interest.

The court below has placed an entirely new interpretation upon Section 23(1) of the Revenue Acts by holding thereunder that the holder of a fee interest in property is not entitled to a deduction for depreciation whereas the statute definitely and clearly gives the deduction to a mere life tenant. We think that the decision of the court below does not properly interpret the plain language of the statute, the Treasury Regulations and the intent of Congress in enacting Section 23(1) of the Revenue Acts, as shown by the Congressional Committee reports.

Counsel can find no ruling or decided case in which it has been held that the owner of a fee interest in property or the owner of an interest greater than that of a life tenant is not entitled to a deduction for depreciation.

In a substantial number of cases it has been held that a mere life beneficiary is entitled to depreciation and depletion deductions. *Freuler v. Helvering*, 291 U. S. 35, 41; *Helvering v. Falk et al.*, 291 U. S. 183, 186; *Chisholm v. United States*, 85 Ct. Cl. 199, 19 F. Supp. 274; *Commissioner v. Edna C. Gutman* (C. C. A. 2), 143 F. (2d) 201, affirming *Edna C. Gutman v. Commissioner*, 1 Tax Court 365; *Sue Carol v. Commissioner*, 30 B. T. A. 443.

The question here involved is of the greatest importance and interest to all trust beneficiaries and the owners of interests in trust property. The court's decision, depriving the holder of an interest greater than that of a life tenant, from depreciation deductions is of far reaching effect. In fact, the importance of the question involved was stressed by Judge Madden in his concurring opinion (R. 40) when he said, in referring to the statute: "If it does mean what I have suggested, it is of great importance since, probably, a large proportion of trust instruments are silent on the question of setting up depreciation reserves".

Also, the learned judges of the court below, although agreeing in the decision promulgated, disagreed as to the reasons for reaching their conclusion.

2. The petitioner, as the owner of a fee interest in one-third of the properties of the estate (life estate plus remainder interest) is, we think, entitled under the plain language and intent of the statute to deduct from her gross income one-third of the depreciation sustained by the properties of the estate.

Section 23(1) of the Revenue Acts of 1934 and 1936 was first enacted as Section 23(k) of the Revenue Act of 1928. Section 23(k) of the 1928 Act was enacted by Congress for the relief of life beneficiaries and life tenants. (Senate Report No. 960, 70th Cong., 1st Sess., p. 20; House Conference Report No. 1882, 70th Cong., 1st Sess., pp. 11-12; *Carol v. Commissioner*, 30 B. T. A. 443.)

The pertinent section of the statute has been construed by the Court of Claims not as a relief measure, but as statutory authority for depriving a fee owner from depreciation deductions. The decision of the court below denies to the owner of a life estate, plus a remainder interest, the deduction which the statute grants unto a mere life tenant.

3. The decision of the Court of Claims conflicts in principle with the following cases, holding that a mere life beneficiary is entitled to the depreciation deduction:

Freuler v. Helvering, 291 U. S. 35, 54 S. Ct. 308;

Helvering v. Falk, 291 U. S. 183, 54 S. Ct. 353;

Commissioner v. Edna C. Gutman (C. C. A. 2), 143 F. (2d) 201, affirming *Edna C. Gutman v. Commissioner*, 1 Tax Court 365.

We think that the decision of the court below is not in accord with its own decision in *Chisholm v. United States*, 85 Ct. Cl. 199, 19 Fed. Supp. 274.

In the foregoing cases mere life beneficiaries were held to be properly entitled to depreciation deductions. In the instant case the owner of a life estate, plus a remainder interest, has been denied the deduction.

Counsel for petitioner certifies that in his opinion this petition is well founded and is not interposed for delay.

It is respectfully submitted that this petition should be granted.

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BRIEF IN SUPPORT OF PETITION

I

Legislative History of Section 23(l)

Section 23(l) of the Revenue Acts of 1934 and 1936, here involved, was first enacted by Congress as Section 23(k) of the Revenue Act of 1928, c. 852, 45 Stat. 791.

In presenting the new section, the Senate Finance Committee made the following comment (S. Rep. No. 960, 70th Cong., 1st Sess., p. 20 (1939-1 Cum. Bull. (Part 2) 409, 422-423):

SECTION 23 (K) AND (L). DEPRECIATION AND DEPLETION—LIFE ESTATES AND TRUSTS

The House bill makes no change in existing law with respect to these deductions. The committee proposes to amend and clarify the law governing the manner in which the deductions shall be apportioned as between life tenant and remainderman or trustee and beneficiary. There is uncertainty and considerable hardship in these two classes of cases under the existing law.

In the case of life tenant and remainderman the bill provides that the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property—that is, in accordance with the estimated useful life of the property—and shall be allowed to the life tenant each year that he holds the property. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the

depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee. The bill contains similar provisions as to the deduction for depletion.

A clerical change is made in section 24(b) of the bill to obviate any conflict between that section and the provisions of sections 23 (k) and 23 (l).

This amendment was adopted and the House Report submitting the Conference Report contains the following (H. Conference Rep. No. 1882, 70th Cong., 1st Sess., pp. 11-12 (1939-1 Cum. Bull. (Part 2) 444, 445):

Amendment No. 30: Under existing law difficulty has been experienced in determining and allowing the deduction for depreciation in cases where property is held by one person for life with remainder to another person; and the deduction, in the case of property held in trust, is allowable only to the trustee. The Senate amendment provides that a life tenant, for the purpose of this deduction, shall be considered as the absolute owner; so that he will be entitled to the deduction during his life, and that thereafter the deduction, if any, will be allowed to the remainderman. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while

if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee. The bill contains similar provisions as to the deduction for depletion. The Senate amendment provides for an equitable apportionment of the deduction in these cases; and the House recedes.

It appears from the reports of Congress referred to above and the decision of the Board of Tax Appeals in *Sue Carol v. Commissioner, supra*, that Section 23(k) of the 1928 Act was enacted and reenacted as Section 23(l) of the 1934 and 1936 Acts as a relief measure for the benefit of life tenants and life beneficiaries. We think it clear from the legislative history of the pertinent section of the statute that Congress did not intend to limit the deductions for depreciation to which absolute owners or the owners of fee interests have always been entitled. In fact, Congress provided under Section 23(l) that: "In the case of property held by one person for life with the remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant."

If Congress intended to grant depreciation deductions to mere life tenants, we believe it naturally follows that the owner of a greater interest than that of a mere life tenant is entitled to depreciation allowances.

II

The Nature of Petitioner's Interest in the Properties of the Trust Estate

Under the will here involved the taxpayer was entitled to one-third of the entire net income of the trust for life or until the termination of the trust (R. 28). Upon the

termination of the trust the trustee was required to convey to the taxpayer her one-third interest of the corpus of the trust and any accumulations thereof if living, and if dead, to those she may have by deed or will designated. In addition, the taxpayer had the right under the will of the decedent, Charles Netcher, to dispose of her share of the property by her own will or deed as she desired. Thus the petitioner, having a life interest, plus a remainder interest in the corpus of the trust property, had a fee interest in one-third of the trust property. Section 29.14, Vol. 27, Jones Illinois Statutes Annotated; *Strawbridge v. Strawbridge*, 220 Ill. 61, 77 N. E. 78; *Drager v. McIntosh*, 316 Ill. 368, 38 N. E. 1029; *Melies v. Beatty*, 313 Ill. 418, 145 N. E. 146; *Becker v. Becker*, 206 Ill. 53.

Thus as a holder of a fee simple or interest in one-third of the corpus of the estate, the taxpayer herein is entitled under the statute to her deduction for depreciation on one-third of the trust property.

The Court of Claims held that the petitioner had a one-third interest in the annual net income of the trust and a one-third remainder interest in the trust corpus (R. 34).

In deciding the question of depreciation deductions, the Court of Claims followed the decision of the United States Circuit Court of Appeals for the Seventh Circuit in *Commissioner of Internal Revenue v. Francice Netcher*, 143 F. (2d) 484, certiorari denied October 23, 1944.

It is true that the Case of *Commissioner of Internal Revenue v. Francice Netcher* involved beneficiaries of the same trust estate as is here involved. The taxpayers involved were the children and grandchildren of Charles Netcher, deceased. However, the taxpayers and beneficiaries under consideration by the Court in the *Netcher* case were mere life beneficiaries. The petitioner here, although a beneficiary under the will of Charles Netcher, deceased, had a far greater interest in the trust estate properties

than the life beneficiaries. She had not only a life estate but a remainder interest as well. She was the owner of a fee interest as shown hereinabove. We think that the *Netcher* case is clearly distinguishable from the case at bar because the property interests of the taxpayer involved were entirely different. The beneficiaries in the *Netcher* case held no remainder interests.

We think that the court below erred by ignoring the fee interest of this petitioner and by practically adopting the opinion of the Circuit Court of Appeals in the *Netcher* case involving far different property interests in the same estate.

III

The Case Involves Important Question of Federal Tax Law

The decision of the court below has a far reaching effect on depreciation deductions for all trust estates and especially in those cases where beneficiaries have both life and remainder interests and/or legal or equitable fee interests. We think that the decision for the first time denies the holder of an equitable fee interest the right of a deduction for depreciation and that the question is so important to all trust estates that it should be settled by this Honorable Court.

Moreover, we believe that the decision of the court below is not in accordance with the principles enunciated by this Court in *Freuler v. Helvering*, *supra* (291 U. S. 35, 54 S. Ct. 308) and *Helvering v. Falk*, *supra* (291 U. S. 183, 54 S. Ct. 353). We also believe that the decision of the court below conflicts in principle with *Commissioner v. Gutman*, *supra* (C. C. A. 2, 143 F. (2d) 201) and the decision of the Court of Claims itself in *Chisholm v. U. S.*, *supra*, 85 Ct. Cl. 199, 19 F. Supp. 274.

In the above mentioned cases mere life beneficiaries were allowed deductions for depreciation or depletion, whereas the taxpayer in the case at bar had a life estate plus a remainder interest in one-third of the corpus of the estate property.

Respectfully submitted,

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APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

Sec. 23. *Deductions from gross income.*

In computing net income there shall be allowed as deductions:

* * * * *

(1) Depreciation.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

Similar provisions are contained in Section 23(1) of the Revenue Act of 1934, c. 277, 48 Stat. 680.

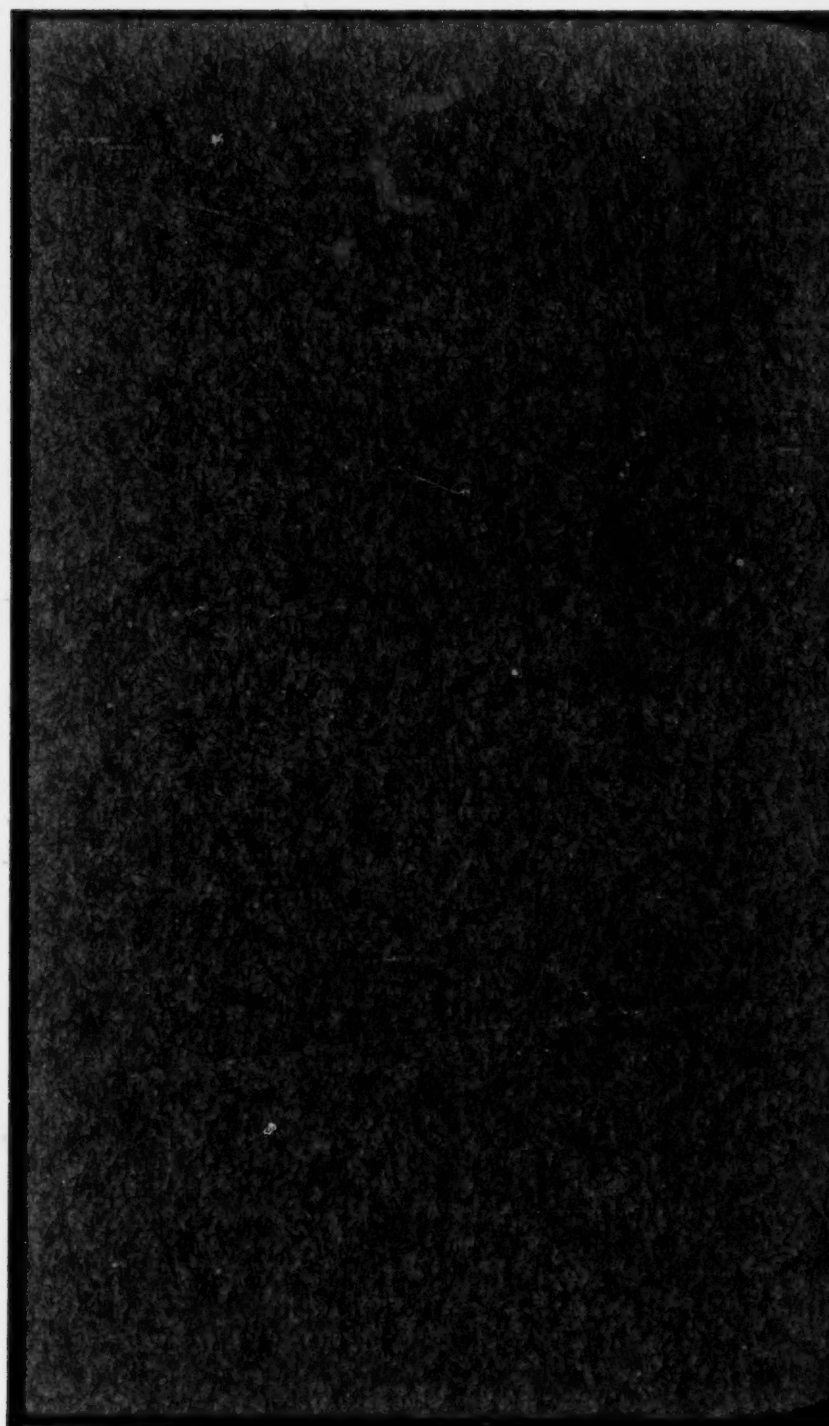
Treasury Regulations 94, promulgated under the Revenue Act of 1936:

Art. 23 (1)-1. *Depreciation.*— * * * In the case of property held by one person for life with remainder to another person, the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, will be allowed to the remainderman. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is

allocable to the trustees and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee.

Similar provisions are contained in Article 23(1)-1 of Treasury Regulations 86, promulgated under the Revenue Act of 1934.

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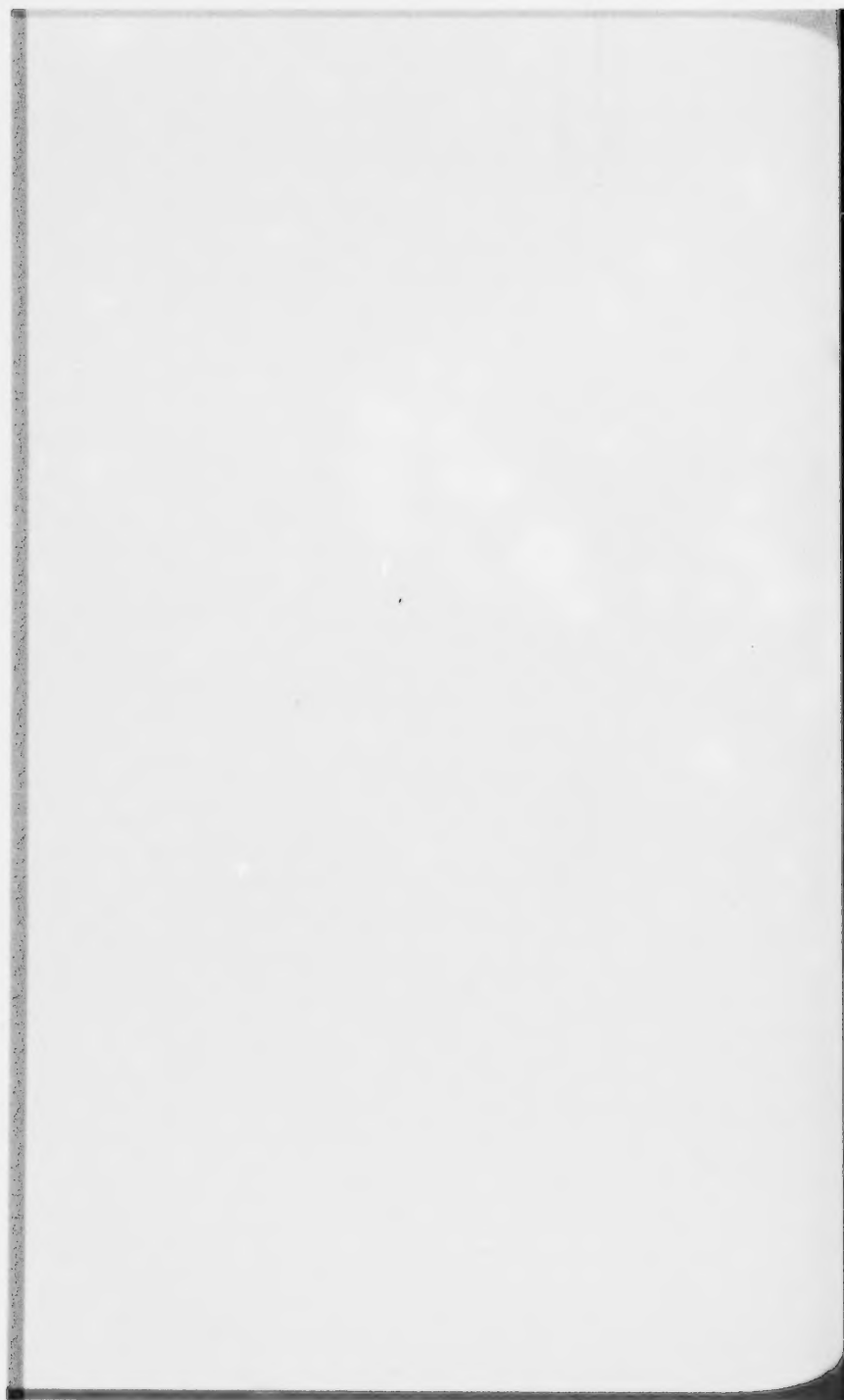
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(1)



In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 725

MOLLIE NETCHER NEWBURY, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT
OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Claims (R. 33-39) is reported in 57 F. Supp. 168. The concurring opinion of Judge Madden (R. 40-42), in which Judge Whitaker joined, is also reported therein.

JURISDICTION

The judgment of the Court of Claims was entered on October 2, 1944 (R. 43). The petition for a writ of certiorari was filed on December 2, 1944 (R. 43). The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925, as amended by the Act of May 22, 1939.

QUESTION PRESENTED

Whether the income beneficiary of a certain trust who also had a remainder interest subject to invasion for the benefit of other beneficiaries is entitled, under Section 23 (1) of the Revenue Acts of 1934 and 1936, to an allowance for depreciation on trust assets not absorbed by the trust income, where the trust instrument as construed by the court below required that the trustee, in determining the distributable income, should withhold an amount sufficient to offset depreciation.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.¹

In computing net income there shall be allowed as deductions:

* * * * *

(1) *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income benefi-

¹ Similar provisions are contained in Section 23 (1) of the Revenue Act of 1936, c. 690, 49 Stat. 1648.

ciaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

* * * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (1)-1.² *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the property in the business, equal the cost or other basis of the property determined in accordance with section 113. Due regard must also be given to expenditures for current upkeep. In the case of property held by one person for

² Similar provisions are contained in Article 23 (1)-1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936.

life with remainder to another person, the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, will be allowed to the remainderman. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee.

STATEMENT

The special findings of fact of the Court of Claims (R. 26-33) may be summarized as follows:

Petitioner is the widow of Charles Netcher and is also trustee of a trust created under the will of her husband of which she is one of the beneficiaries. This suit is brought by her in her individual capacity. (R. 26.)

By the will of Charles Netcher who died on June 19, 1904, his wife and four children surviving (R. 26), his entire estate, aside from a special bequest to his widow, was left in trust, the widow being named trustee. One-third of the net income from the trust estate was to be paid to her for life, and she was granted the power, by will or deed, to dispose of the right to such income from the date of her death until the termination of the trust. The income from the remaining two-thirds of the estate was to be divided by the trustee into four equal portions, each of such portions to be thereafter held in trust by the trustee as a separate fund for each of the decedent's children. (R. 28-29.)

It was further provided by the will that until each of such children attained the age of twenty-five years respectively, the trustee should use and expend so much of each separate trust fund held for each child as in her opinion was necessary for the education and support of such child. On attaining his or her twenty-fifth year each child was to become entitled thereafter to receive one-fourth of the entire net income of the above mentioned two-thirds of the principal trust es-

tate. (R. 33-34.) The instrument further provided that at any time after the children had reached the age of twenty-five, the trustee might pay over to any child in her discretion the sum of \$25,000 and after attainment of the age of thirty years the trustee might pay over to the child the sum of \$100,000, both such payments to be made out of the separate trust fund provided for the benefit of the child to whom such payments are made, or if such separate trust fund was not sufficient then out of the principal of the principal trust estate, provided (R. 29)—

it be not necessary to sell any of the real estate in Block Fifty-eight (58) of the Original Town of Chicago, in Cook County, Illinois, for the purpose of making such payments, it being my wish that said real estate in said Block Fifty-eight (58) shall be held together for the benefit of my entire Estate and the beneficiaries thereunder, subject to the power of sale or other disposition hereinafter given to the executor or executors, trustee or trustees under this Will.

One of the assets included in the estate was real estate in Chicago, Illinois. Following the decedent's death the widow, acting as trustee under the will, borrowed the necessary funds and erected on this property a 17-story fireproof store and office building at a cost of \$5,714,759.52 which was thereupon leased to the Boston Store. (R. 27.)

For the calendar years 1935, 1936, and 1937 the sum of charges for ground rent, interest on mortgage, taxes, and depreciation exceeded the rents from the building by considerable amounts. These deficits were treated as part of expenses of the so-called principal trust already referred to. The charges for depreciation for each of the years were reasonable allowances for losses sustained through exhaustion, wear, and tear of the building. In computing the distributable net income of the trust created by the will, the trustee has continuously deducted from the gross income of the trust estate an allowance for loss sustained through exhaustion, wear, and tear of improvements, and has set up a reserve to cover the loss so sustained. (R. 27-28.)

The Commissioner of Internal Revenue determined that depreciation sustained on properties of the principal trust estate in the taxable years was deductible only by the trustee in computing net income of the trust and that any depreciation thus set up and consequently reported in the net loss of the estate was not subject to deduction by the individual beneficiaries from income received by them from other sources. (R. 32.)

As a result of this action by the Commissioner of Internal Revenue, deficiencies were determined and assessed against the petitioner for the years 1935, 1936, and 1937 and were duly paid. Timely claims for refund were rejected and this suit was

brought in the Court of Claims within two years of such rejection. (R. 32-33.) The Court of Claims sustained the Commissioner and rendered judgment against the petitioner (R. 33-42, 43).

ARGUMENT

The question of whether certain of the income beneficiaries under the trust created by the will of Charles Netcher were entitled to depreciation deductions for the year 1937 was decided in favor of the Government by the Circuit Court of Appeals for the Seventh Circuit in *Commissioner v. Netcher*, 143 F. 2d 484. That court held that although the will contained no specific provisions as to depreciation, it was clearly the testator's intention that the trustee and not the beneficiaries should take the depreciation deduction. Certiorari was denied in that case on October 23, 1944 (No. 418).

The holding of the Court of Claims that the petitioner, another beneficiary under the same trust, is not entitled to the depreciation deduction, is in accord with that of the Seventh Circuit. In fact, the petition for certiorari in this case raises substantially the same issues as were raised there and, for this reason, we do not believe it necessary to discuss the various issues raised in the petition at any great length.

The holding of the court below was based upon the ground that the provisions of the will rather

clearly "expressed the intention and desire of the decedent that a deduction for depreciation of the trust property should be taken by the trustee for the Trust Estate in determining the net income distributable to the beneficiaries" (R. 37). Since Section 23 (1) of the Revenue Acts of 1934 and 1936, *supra*, pp. 2-3, provides that in the case of property held in trust the allowable deduction for depreciation shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the trust instrument, the beneficiaries are clearly not entitled to the deduction for depreciation but, as the court below held, the trustee is the only one entitled thereto.³

Petitioner attempts to distinguish her situation from that of the beneficiaries in the *Netcher* case upon the ground that she was not merely a life beneficiary but had a remainder interest as well⁴

³ The petitioner and the other beneficiaries for many years took the view that the trustee was required to set up a depreciation reserve, and in an earlier case relating to their income taxes for the years 1923 to 1925 (*Newbury v. Commissioner*, 26 B. T. A. 101), the Board of Tax Appeals so held, and the Commissioner acquiesced (XI-2 Cum. Bull. 7 (1932)).

⁴ The provision in the will that after the termination of the trust one-third of the principal trust estate and accumulations was to be conveyed to the widow (petitioner herein), if living, or, if dead, to others designated by her, was not included by the court below in its special findings of fact (R. 26-33). However, the entire will was in evidence in the court below (Exhibit 1, attached to the stipulation of facts

and that, as the holder of an equitable fee interest she had the right to depreciation deductions (Pet. 5, Br. 12-14). In the first place, however, petitioner's remainder interest in the corpus was subject to invasion if necessary to make the \$25,000 and \$100,000 payments to the children (R. 29). Under the applicable Illinois law, moreover, petitioner certainly does not have an equitable or a legal fee, as she may be suggesting (Br. 12-14), for even aside from this possibility of invasion, the trust here established was not a "dry or passive trust", and there could be no merger of her life and remainder interests. *Burbach v. Burbach*, 217 Ill. 547; see 1 Scott on *Trusts*, sec. 99.3.

Petitioner relies upon the provision, in Section 23 (1), that in the case of property held by one person for life with a remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. She urges that since the life tenant may take a depreciation deduction, she, having more than a life interest, certainly may. But petitioner ignores, as she did in the court below, the provisions in Section 23 (1) dealing specifically with property held in trust. These provisions first appeared in

filed by the parties), and the pertinent portion may also be found in the petition in the court below (R. 6).

the Revenue Act of 1928 and have been in all succeeding Revenue Acts. As Judge Madden said, in the court below (R. 42):

It was not possible, in the statutory scheme, to treat the trust situation exactly like the legal life tenant and remainder situation, since in the latter case there is frequently no ascertainable person to represent the permanent interest in the property, and even if there is such a person, he has no income from it. It probably seemed fair to Congress, therefore, to give the life tenant the depreciation allowance even though the loss is, largely, not his loss, rather than to deny any depreciation allowance to anyone.

The Committee Reports relating to the 1928 Act^a clearly show that there was to be a distinction between the situation of an ordinary life tenant where the deduction was to be computed as if the life tenant were the absolute owner of the property and accordingly allowed to him and that of a beneficiary under a trust where the deduction was to be allocated between the trustee and the beneficiaries. Those reports contain the following example where the property is held in trust:

^a S. Rep. No. 960, 70th Cong., 1st Sess., p. 20 (1939-1 Cum. Bull. (Part 2) 409, 423); H. Rep. No. 1882, 70th Cong., 1st Sess., pp. 11-12 (1939-1 Cum. Bull. (Part 2) 444, 445).

* * * if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee.

This example was incorporated in the regulations, and it has remained unaltered therein for many years. Article 201, Treasury Regulations 74 and 77; Article 23 (1)-1, Treasury Regulations 86, 94 and 101; Section 19.23 (1)-1, Treasury Regulations 103; Section 29.23 (1)-1, Treasury Regulations 111. It is entitled, therefore, to substantial weight in construing the statute. *Taft v. Commissioner*, 304 U. S. 351; *United States v. Dakota-Montana Oil Co.*, 288 U. S. 459; *Magruder v. Washington, B. & A Realty Corp.*, 316 U. S. 69.

The holding of the court below is in accord with the statute and these regulations, and the petitioner is not entitled to the claimed deduction for depreciation.

CONCLUSION

The decision of the court below is correct. There is no conflict and the petition should be denied.

Respectfully submitted.

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